



# FINRA Firm Grouping Member Forum: **Retail**

December 9, 2021 | Virtual

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## **Brokers With a Significant History of Misconduct**

**Thursday, December 9**

**2:30 p.m. – 3:00 p.m.**

Join FINRA staff as they discuss the new broker with significant history of misconduct obligations. Panelists review the implications of retaining or hiring brokers with such a history.

**Moderator:** Kristin Ferrante  
Principal Analyst, Risk Monitoring – Jericho Office  
FINRA Member Supervision

**Panelists:** Jennifer Crawford  
Vice President, Litigation  
FINRA Enforcement

Jennifer Danby  
Application Manager, MAP  
FINRA Member Supervision

Paxton Dunn  
Manager, Risk Monitoring – Dallas Office  
FINRA Member Supervision

## Brokers With a Significant History of Misconduct Panelist Bios:

### Moderator:



**Kristin Ferrante** is Risk Monitoring Principal Analyst in FINRA's Member Supervision department. Ms. Ferrante joined FINRA 11 years ago. Prior to FINRA, she served as a Vice President within the Compliance department at Citi Alternative Investments. Prior to that, she began her career as an examiner at the New York Stock Exchange. Ms. Ferrante graduated from Syracuse University with a degree in Finance and Economics.

### Panelists:



**Jen Crawford** is Vice President of Litigation in the Enforcement Department, responsible for overseeing Enforcement's nationwide litigation and appellate programs. Prior to assuming this role, she was a Hearing Officer in FINRA's Office of Hearing Officers. Ms. Crawford joined FINRA in 2012 and was a Director in Enforcement until 2018. Prior to joining FINRA, she was a Senior Counsel in the Division of Enforcement at the U.S. Securities and Exchange Commission where she investigated and litigated enforcement matters in federal court and in administrative proceedings. Ms. Crawford holds a B.S. in Finance from Seton Hall University and J.D. from Catholic University.



**Jennifer Danby** joined the FINRA New York office in 2010 and has acted as a Manager in the Membership Application Program (MAP) Group since 2012. The MAP Group is responsible for the review of New Member and Continuing Member Applications as well as other matters for FINRA firms. Prior to this, Ms. Danby spent more than 10 years in the financial services industry, with a primary focus on anti-money laundering and sales practice compliance.



**Paxton Dunn**, Manager Risk Monitoring Standards, has spent more than 20 years in the financial services industry with 18 years at FINRA. In July 2020 Mr. Dunn began his current role, where he is responsible for management of centralized risk monitoring functions and ensuring policies and procedures are appropriate and consistent across FINRA's risk monitoring program. Prior to his current role, he was a Risk Monitoring Analyst in Dallas Office for 10 years and an examiner in the Dallas office for seven years. Before coming to FINRA, Mr. Dunn spent 18 months as an Account Executive for CitiStreet. In 2002, Mr. Dunn earned his BBA in Finance from Angelo State University. In May 2017 he became a Certified Anti-Money laundering Specialist (CAMS), and in June 2021 a Certified Fraud Examiner (CFE). Outside of FINRA, Mr. Dunn is involved with various charities, and is currently a Board Member for the Epilepsy Foundation of Texas.

# Brokers With a Significant History of Misconduct

# Panelists

## ○ Moderator

- Kristin Ferrante, Principal Analyst, Risk Monitoring – Jericho Office, FINRA Member Supervision

## ○ Panelists

- Jennifer Crawford, Vice President, Litigation, FINRA Enforcement
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## **Brokers With a Significant History of Misconduct**

**Thursday, December 9**

**2:30 p.m. – 3:00 p.m.**

### **Resource:**

- FINRA Webpage: Checklists for Mandatory Materiality Consultations Under Rules 1017(a)(6) and 1017(a)(7)

[www.finra.org/rules-guidance/guidance/materiality-consultation-process/checklist-under-rules-1017a6 a7](https://www.finra.org/rules-guidance/guidance/materiality-consultation-process/checklist-under-rules-1017a6-a7)

# Regulatory Notice

21-09

## Protecting Investors From Misconduct

### FINRA Adopts Rules to Address Brokers With a Significant History of Misconduct

**Effective Dates:** Amendments to the FINRA Rule 9200 Series, FINRA Rule 9300 Series, and FINRA Rule 9556: April 15, 2021; Amendments to FINRA Rule 8312: May 1, 2021; Amendments to the FINRA Rule 9520 Series and Funding Portal Rule 900: June 1, 2021; Amendments to the FINRA Rule 1000 Series and the Capital Acquisition Broker Rule 100 Series: September 1, 2021

### Executive Summary

FINRA has adopted new rules to address brokers with a significant history of misconduct and the broker-dealers that employ them.<sup>1</sup> The new rules:

- ▶ allow a Hearing Officer to impose conditions or restrictions on the activities of a Respondent member firm or Respondent associated person, and require the member firm employing a Respondent associated person to adopt heightened supervisory procedures for such an associated person, when a disciplinary matter is appealed to the National Adjudicatory Council (NAC) or called for NAC review;
- ▶ require member firms to adopt heightened supervisory procedures for statutorily disqualified associated persons during the period a statutory disqualification eligibility request is under review by FINRA;
- ▶ require disclosure through FINRA BrokerCheck® of the status of a member firm as a “taping firm” under FINRA Rule 3170 (Tape Recording of Registered Persons by Certain Firms); and
- ▶ require a member firm to submit a written request to FINRA’s Department of Member Regulation, through the Membership Application Group, seeking a materiality consultation and approval of a continuing membership application, if required, when a natural person seeking to become an owner, control person, principal or registered person of the member firm has, in the prior five years, one or more “final criminal matters” or two or more “specified risk events.”

March 10, 2021

### Notice Type

- ▶ New Rule

### Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Registered Representatives
- ▶ Registration
- ▶ Senior Management

### Key Topics

- ▶ BrokerCheck
- ▶ Brokers With a Significant History of Misconduct
- ▶ Conditions and Restrictions
- ▶ Continuing Membership Applications
- ▶ Disciplinary Proceedings
- ▶ Eligibility Proceedings
- ▶ Expedited Proceedings
- ▶ Heightened Supervision
- ▶ Materiality Consultations
- ▶ Taping Firm
- ▶ Taping Rule

### Referenced Rules & Notices

- ▶ CAB Rule 111
- ▶ FINRA Rules 1011, 1017, 3170, 8312, 9235, 9285, 9311, 9312, 9321, 9522 and 9556
- ▶ Funding Portal Rule 900
- ▶ IM-1011-1
- ▶ IM-1011-3
- ▶ Regulatory Notices 18-15, 18-16 and 18-17
- ▶ Securities Exchange Act of 1934

The amendments to the FINRA Rule 9200 Series (Disciplinary Proceedings), the FINRA Rule 9300 Series (Review of Disciplinary Proceeding by National Adjudicatory Council and FINRA Board; Application for SEC Review), and FINRA Rule 9556 (Failure to Comply with Temporary and Permanent Cease and Desist Orders, or Orders that Impose Conditions or Restrictions) become effective April 15, 2021.

The amendments to FINRA Rule 8312 (FINRA BrokerCheck Disclosure) become effective May 1, 2021.

The amendments to the FINRA Rule 9520 Series (Eligibility Proceedings) and Funding Portal Rule 900 (Code of Procedure) become effective June 1, 2021.

The amendments to the FINRA Rule 1000 Series (Member Application and Associated Person Registration), the Capital Acquisition Broker Rule 100 Series (Member Application and Associated Person Registration) become effective September 1, 2021.

The rule text is available in [Attachment A](#).

Questions concerning this *Notice* should be directed to:

- ▶ Kosha Dalal, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-6903 or [Kosha.Dalal@finra.org](mailto:Kosha.Dalal@finra.org); or
- ▶ Michael Garawski, Associate General Counsel, OGC, at (202) 728-8835 or [Michael.Garawski@finra.org](mailto:Michael.Garawski@finra.org).

## Background & Discussion

FINRA uses a combination of tools to reduce the risk of harm to investors from member firms and the brokers they hire that have a history of misconduct. These tools include assessments of applications member firms file to retain or employ an individual subject to a statutory disqualification, reviews of membership and continuing membership applications (CMAs), disclosure of brokers' regulatory backgrounds, supervision requirements, focused examinations, risk monitoring and disciplinary actions.

For several years, FINRA has been taking steps to strengthen its tools for responding to brokers with a significant history of misconduct and the firms that employ them. As part of this initiative, FINRA has:

- ▶ published [Regulatory Notice 18-15](#) (Heightened Supervision), which reiterates the existing obligation of member firms to implement for such individuals tailored heightened supervisory procedures under Rule 3110 (Supervision);
- ▶ published [Regulatory Notice 18-17](#) (FINRA Revises the Sanction Guidelines), which announced revisions to the FINRA Sanction Guidelines;
- ▶ raised fees for statutory disqualification applications;<sup>2</sup>

- ▶ revised the qualification examination waiver guidelines to permit FINRA to more broadly consider past misconduct when considering examination waiver requests;<sup>3</sup> and
- ▶ proposed rule changes to address member firms with a significant history of misconduct.<sup>4</sup>

The new rules establish additional investor protections against individuals with a significant history of misconduct and the firms that employ them.

### **Enhancing Investor Protection During the Pendency of an Appeal or Call-for-Review Proceeding**

FINRA has amended the Rule 9200 Series (Disciplinary Proceedings) and the Rule 9300 Series (Review of Disciplinary Proceeding by National Adjudicatory Council and FINRA Board; Application for SEC Review) to address investor protection concerns during the pendency of an appeal, or National Adjudicatory Council (NAC) review of, a Hearing Panel or Hearing Officer disciplinary decision, by (1) authorizing Hearing Officers to impose conditions and restrictions on disciplined Respondents and (2) requiring member firms to adopt heightened supervision plans concerning their associated persons who are disciplined Respondents.

#### **Conditions and Restrictions**

New Rule 9285 authorizes the imposition of conditions or restrictions on disciplined Respondents during the pendency of an appeal or call for review of a disciplinary decision, where reasonably necessary for the purpose of preventing customer harm. The conditions and restrictions would target the misconduct demonstrated in the disciplinary proceeding and be tailored to the specific risks the Respondent poses during the appeal period.<sup>5</sup>

Hearing Officers can impose conditions or restrictions during the period an appeal or review proceeding is pending to target the demonstrated bad conduct of a Respondent during the pendency of the appeal or review and add an interim layer of investor protection while the disciplinary proceeding remains pending. Conditions and restrictions will help protect investors by potentially preventing associated persons and firms found to have violated a statute or rule from engaging in additional misconduct during the appeal process.

Rule 9285(a) governs the seeking of, and imposition by a Hearing Officer of, conditions and restrictions. The rule provides that, within 10 days after service of a notice of appeal from, or the notice of a call for NAC review of, a disciplinary decision in which a Hearing Officer or Hearing Panel finds that a Respondent violated a statute or a rule provision, the Department of Enforcement (Enforcement) may file a motion for the imposition of conditions or restrictions on the activities of a Respondent that are reasonably necessary for the purpose of preventing customer harm. The rule further provides that the Hearing Officer who participated in an underlying disciplinary proceeding shall have jurisdiction to rule upon a motion for the imposition of conditions or restrictions.



Rule 9285(b) sets forth the process for an expedited review of a Hearing Officer order that imposes conditions and restrictions. The rule allows a Respondent to file, within 10 days after service of a Hearing Officer order imposing conditions or restrictions, a motion with the NAC's Review Subcommittee to modify or remove any or all of the conditions or restrictions. In any such motion, the Respondent has the burden to show that the conditions or restrictions imposed are not reasonably necessary for the purpose of preventing customer harm. The rule further provides that the Review Subcommittee has the authority to approve, modify or remove any and all of the conditions or restrictions, and that the filing of a motion to modify or remove conditions or restrictions shall stay the effectiveness of the conditions or restrictions until the Review Subcommittee rules on the motion. The rule contains other procedural provisions concerning the motions process and the deadlines for issuing written orders and rulings.<sup>6</sup>

Unlike sanctions that a Hearing Panel or a Hearing Officer imposes, which are automatically stayed and not enforced against the Respondent during the pendency of the NAC appeal or review proceeding,<sup>7</sup> conditions and restrictions imposed pursuant to Rule 9285 remain in place until FINRA's final decision takes effect and all appeals are exhausted.<sup>8</sup>

FINRA also has amended and retitled Rule 9556 (Failure to Comply with Temporary and Permanent Cease and Desist Orders, or Orders that Impose Conditions or Restrictions). Prior to the amendments, Rule 9556 governed only expedited proceedings for failures to comply with temporary and permanent cease and desist orders. The amendments to Rule 9556 grant FINRA staff the authority to bring an expedited proceeding against a Respondent that fails to comply with conditions and restrictions imposed pursuant to Rule 9285 and create the process for the new expedited proceeding.<sup>9</sup>

#### **Mandatory Heightened Supervision**

To further bolster investor protection during the pendency of an appeal from, or a NAC review of, a Hearing Panel or Hearing Officer disciplinary decision, new Rule 9285 also requires member firms to adopt a written heightened supervision plan for an associated person who is found to have violated a statute or rule provision in a disciplinary decision, when that disciplinary decision has been appealed or called for NAC review.<sup>10</sup> The plan of heightened supervision shall remain in place until FINRA's final disciplinary decision takes effect.<sup>11</sup>

The new rule requires that the plan of heightened supervision, and any amended plan, comply with FINRA Rule 3110 (Supervision), be reasonably designed and tailored to include specific supervisory policies and procedures that address the violations the Hearing Panel or Hearing Officer finds; be reasonably designed to prevent or detect a reoccurrence of these violations; at a minimum, include the designation of an appropriate registered principal who is responsible for carrying out the plan of heightened supervision, and take

into account any conditions and restrictions the Hearing Officer or Review Subcommittee imposes; and be signed by the designated principal.<sup>12</sup> The new rule also establishes deadlines for when the member firm, and other member firms with which the Respondent associates, must file the written plan of heightened supervision with FINRA and provides instructions on how to do so.<sup>13</sup>

The amendments to the FINRA Rule 9200 Series (Disciplinary Proceedings), the FINRA Rule 9300 Series (Review of Disciplinary Proceeding by National Adjudicatory Council and FINRA Board; Application for SEC Review), and FINRA Rule 9556 (Failure to Comply with Temporary and Permanent Cease and Desist Orders, or Orders that Impose Conditions or Restrictions) apply to disciplinary proceedings and expedited proceedings that are commenced, by the filing of a complaint or the issuance of a notice, on or after April 15, 2021.

### **Enhancing Investor Protection During the Period When FINRA Is Reviewing an Eligibility Application**

FINRA has amended and retitled FINRA Rule 9522 (Initiation of Eligibility Proceeding; Member Regulation Consideration; and Requirements for an Interim Plan of Heightened Supervision) in the FINRA Rule 9520 Series (Eligibility Proceedings) to require a member firm that files an application to continue associating with a disqualified person to also include an interim plan of heightened supervision that would be in effect throughout the entirety of the application review process.

As background, the Securities Exchange Act of 1934 (Exchange Act) sets out the types of misconduct that presumptively exclude brokers from engaging in the securities business, identified as statutory disqualifications.<sup>14</sup> The Exchange Act and SEC rules thereunder establish a framework within which FINRA evaluates whether to allow an individual who is subject to a statutory disqualification to associate with a member firm.<sup>15</sup> A member firm that seeks to employ or continue the employment of a disqualified individual must file an application seeking approval from FINRA (SD Application).<sup>16</sup> The Rule 9520 Series sets forth rules governing eligibility proceedings, in which FINRA evaluates whether to allow a member, person associated with a member, potential member or potential associated person subject to a statutory disqualification to enter or remain in the securities industry. As part of an SD Application, a member firm will propose a written plan of heightened supervision of the statutorily disqualified person that would become effective upon FINRA's approval of the SD Application to associate with the statutorily disqualified person. Generally, the continued association of a statutorily disqualified person approved through a FINRA eligibility proceeding is conditioned on the individual being subject to a heightened supervision plan.<sup>17</sup>

Previously, FINRA issued guidance that a member firm's continuing to associate with a person who becomes disqualified while associated with the firm raises significant investor protection concerns, and that such a firm should evaluate the facts and circumstances

to make a determination of whether adopting and implementing an interim plan of heightened supervision during the pendency of an SD Application would be appropriate.<sup>18</sup> FINRA has amended Rule 9522 to require such interim plans of heightened supervision.

Under Rule 9522(f), an application to continue associating with a statutorily disqualified person<sup>19</sup> must include an interim plan of heightened supervision, signed by the appropriately registered principal, and a written representation from the member firm that the statutorily disqualified person is currently subject to that plan. The interim plan of heightened supervision shall be in effect throughout the entirety of the application review process, which shall be concluded only upon the final resolution of the eligibility proceeding.<sup>20</sup> By requiring interim plans of heightened supervision during an eligibility proceeding, the new rule will help limit the potential for customer harm at an earlier point in time and thereby help protect customers.

The amendments to Rule 9522 apply to SD Applications that are filed on or after the effective date of the rule amendments.

FINRA will be amending the MC-400 (Membership Continuance Application) to make changes on that form that correspond to the amendments to the Rule 9520 Series. These changes will include the addition of a link to sample interim plans of heightened supervision.

### **Enhanced Disclosure on BrokerCheck of Taping Firms**

FINRA has amended Rule 8312 (FINRA BrokerCheck Disclosure), which governs the information FINRA releases to the public through its BrokerCheck® system, to enhance the disclosure of which firms are “taping firms.”<sup>21</sup>

FINRA Rule 3170 (Tape Recording of Registered Persons by Certain Firms), also called the Taping Rule, is designed to ensure that a member firm with a significant number of registered persons that previously were employed by “disciplined firms”<sup>22</sup> has specific supervisory procedures in place to prevent fraudulent and improper sales practices or other customer harm. Under the Taping Rule, a member firm with a specified percentage of registered persons who have been associated with disciplined firms in a registered capacity in the last three years is designated as a “taping firm.” A member firm that either is notified by FINRA or otherwise has actual knowledge that it is a taping firm must establish, maintain and enforce special written procedures for supervising the telemarketing activities of all its registered persons. Those procedures must include procedures for recording all telephone conversations between the taping firm’s registered persons and both existing and potential customers, and for reviewing the recordings to ensure compliance with applicable securities laws and regulations and applicable FINRA rules. The Taping Rule also requires taping firms to retain all the recordings for a period of not less than three years and file quarterly reports with FINRA.

Prior to the amendments, Rule 8312(b) required that FINRA release information about, among other things, whether a particular member firm is subject to the provisions of the Taping Rule, but only in response to telephonic inquiries via the BrokerCheck toll-free telephone listing. To provide enhanced disclosure to the public, FINRA has deleted the requirement that FINRA provide that information only in response to telephonic inquiries. As a result, amended Rule 8312(b) requires FINRA to release through BrokerCheck information as to whether a particular member firm is subject to the Taping Rule. Broadening the disclosure through BrokerCheck of the status of a member firm as a taping firm will help inform more investors of the heightened procedures required of a taping firm, which may incent the investors to research more carefully the background of a broker associated with the taping firm. Information that a firm is a taping firm will be displayed on a firm's BrokerCheck report in the summary section, and in ".pdf" versions of a firm's BrokerCheck report. Specifically, those reports will include the text, "This firm is subject to FINRA Rule 3170 (Taping Rule)," in a color or font that is prominent. The alert also will include the text "Click here for more information," with a hyperlink to a page on FINRA's website that provides a clear explanation of the Taping Rule, to help investors understand why the taping firm is subject to heightened procedures.<sup>23</sup>

### **New Obligations on Member Firms That Seek Associations With Persons With a Significant History of Misconduct**

FINRA has amended rules in the FINRA Rule 1000 Series (Member Application and Associated Person Registration)—specifically the rules that govern membership proceedings (MAP Rules)—to impose additional obligations on member firms when a natural person who has, in the prior five years, either one or more "final criminal matters" or two or more "specified risk events" seeks to become an owner, control person, principal or registered person of the member firm.

As background, Rule 1017(a) specifies the changes in a member's ownership, control or business operations that require a CMA and FINRA's approval. A CMA is required for, among other changes, a "material change in business operations."<sup>24</sup> In addition, a CMA is required for business expansions to increase the number of associated persons involved in sales, offices or markets made that are a material change in business operations.<sup>25</sup> However, Interpretive Material IM-1011-1 (Safe Harbor for Business Expansions) creates a safe harbor for incremental increases in these three categories of business expansions. Under this safe harbor provision, a member firm, subject to specified conditions and thresholds, may undergo such business expansions without filing a CMA.<sup>26</sup>

Given recent studies that provide evidence of the predictability of future regulatory-related events for brokers with a history of past regulatory-related events,<sup>27</sup> FINRA has been concerned about instances where a member firm on-boards brokers with a significant history of misconduct and does so within the safe-harbor parameters, thus avoiding prior consultation or review by FINRA. FINRA believes there are instances in which a member

firm's hiring of a broker with a significant history of misconduct—and other associations with such persons—would reflect a material change in business operations. FINRA has amended the MAP Rules to address these concerns and limit the applicability of the IM-1011-1 safe harbor.

Specifically, FINRA has added Rule 1017(a)(7) to require a member firm to file a CMA when a natural person seeking to become an owner,<sup>28</sup> control person,<sup>29</sup> principal or registered person of the member firm has, in the prior five years, one or more “final criminal matters” or two or more “specified risk events”—as defined in amendments to Rule 1011 (Definitions)<sup>30</sup>—unless the member firm has submitted a written request to Member Regulation seeking a materiality consultation for the contemplated activity.<sup>31</sup> Rule 1017(a)(7) applies whether the person is seeking to become an owner, control person, principal or registered person at the person's current member firm or at a new member firm. Rule 1017(a)(7) does not apply, however, when a person is already a representative at a member firm and seeks to add an additional representative-level registration at that same firm or, likewise, when a person is already a principal at a member firm and seeks to add an additional principal registration at that same firm.

Rule 1017(a)(7) is intended to apply to associated persons and owners who may pose greater risks to customers than other associated persons and owners.<sup>32</sup> The rule is based on disclosure events required to be reported on the Uniform Registration Forms. To assist firms' compliance with Rule 1017(a)(7), FINRA will publish shortly on its website a chart that maps the events described in the definitions of “final criminal matter” and “specified risk event” to the relevant disclosure questions and fields on the Uniform Registration Forms. This mapping guidance will be updated as needed.

These amendments to the MAP Rules add a category of “mandatory materiality consultations.”<sup>33</sup> A request for a materiality consultation, for which there is no fee, is a written request from a member firm for FINRA's determination on whether a contemplated change in business operations or activities is material and would therefore require a CMA. The characterization of a proposed change as material depends on an assessment of all the relevant facts and circumstances. Through the materiality consultation, FINRA may communicate with the member firm to obtain further documents and information regarding the contemplated change and its anticipated impact on the member firm. A letter seeking a mandatory materiality consultation under Rule 1017(a)(7) must be submitted through FINRA Gateway®, under the Materiality Consultation section.<sup>34</sup>

A written request for a materiality consultation pursuant to Rule 1017(a)(7) must address the issues that are central to the materiality consultation. Thus, the materiality consultation would focus on, and the member firm would need to provide information relating to, the conduct underlying the individual's “final criminal matters” and “specified risk events,” as well as other matters relating to the subject person, such as disciplinary actions taken by FINRA or other industry authorities, adverse examination findings,

customer complaints, pending or unadjudicated matters, terminations for cause or other incidents that could indicate a threat to public investors. The Department of Member Supervision's (Member Supervision) assessment in the materiality consultation would consider, among other things:

- ▶ whether the "final criminal matters" or "specified risk events" are customer-related;
- ▶ whether they represent discrete actions or are based on the same underlying conduct;
- ▶ the anticipated activities of the person;
- ▶ the disciplinary history, experience and background of the proposed supervisors, if applicable;
- ▶ the disciplinary history, supervisory practices, standards, systems and internal controls of the member firm and whether they are reasonably designed to achieve compliance with applicable securities laws and regulations and FINRA rules;
- ▶ whether the member firm employs or intends to employ in any capacity multiple persons with one or more "final criminal matters" or two or more "specified risk events" in the prior five years; and
- ▶ any other investor protection concerns raised by seeking to make the person an owner, control person, principal or registered person of the member firm.

FINRA will be posting on its website a checklist to assist a member firm when it is required to submit a materiality consultation under Rule 1017(a)(7).

Where FINRA determines in a materiality consultation that a contemplated organizational change is not material, the member firm may effect the contemplated activity. Where FINRA determines that the contemplated change requires a CMA, FINRA would instruct the member firm to file a Form CMA if it intends to proceed with such change, and the member firm may not effect the contemplated activity unless Member Supervision approves the Form CMA.<sup>35</sup> FINRA is separately developing changes to Form CMA to incorporate questions that relate specifically to Rule 1017(a)(7).

Rule 1017(a)(7) also establishes that the safe harbor for business expansions in IM-1011-1 is not available to the member firm when a materiality consultation is required under Rule 1017(a)(7). In a corresponding change, FINRA has added IM-1011-3 (Business Expansions and Persons with Specified Risk Events), which provides that the safe harbor for business expansions in IM-1011-1 is not available to any member firm that is seeking to add a natural person who has, in the prior five years, one or more "final criminal matters" or two or more "specified risk events" and seeks to become an owner, control person, principal, or registered person of the member firm. In such circumstances, if the member firm is not otherwise required to file a Form CMA in accordance with Rule 1017, the member firm must comply with the requirements of Rule 1017(a)(7).

The amendments to the MAP Rules further promote investor protection by applying additional safeguards and disclosure obligations for a member firm's continuing membership and for changes to a current member firm's ownership, control, or business operations. The heightened scrutiny by FINRA of registered representatives, registered principals, owners, and control persons who meet the definitions and criteria will promote investor protection by disincentivizing broker-dealers from engaging in higher-risk activity that could lead to additional regulatory restrictions.<sup>36</sup>

### **Capital Acquisition Brokers (CABs) and Funding Portals**

The rule changes described above impact all member firms, including ones that are funding portals or have elected to be treated as capital acquisition brokers (CABs), given that the funding portal rule set incorporates the Rule 9200 Series and Rule 9300 Series and Rule 9556 by reference, and the CAB rule set incorporates Rules 1011, 1017 and 8312 and the Rule 9200 Series, Rule 9300 Series and Rule 9500 Series by reference. In addition, FINRA has amended CAB Rule 111, to reflect that a CAB would be subject to IM-1011-3, and has amended Funding Portal Rule 900(b) to require heightened supervision during the time an eligibility request is pending.

## Endnotes

1. See Securities Exchange Act Release No. 90635 (December 10, 2020), 85 FR 81540 (December 16, 2020) (Order Approving File No. SR-FINRA-2020-011, as Modified by Amendment No. 1) (Approval Order).
2. See Securities Exchange Act Release No. 83181 (May 7, 2018), 83 FR 22107 (May 11, 2018) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2018-018).
3. See *Regulatory Notice 18-16* (April 2018).
4. See Securities Exchange Act Release No. 90527 (November 27, 2020), 85 FR 78540 (December 4, 2020) (Notice of Filing of File No. SR-FINRA-2020-041).
5. The conditions and restrictions are not intended to be as restrictive as the underlying sanctions imposed in the disciplinary decision and would likely not be economically equivalent to imposing the sanctions during the appeal. See Approval Order, 85 FR 81542.
6. See Rule 9285(a)(1)-(5), Rule 9285(b)(1)-(5).
7. See Rules 9311(b) and 9312(b); see also Rule 9370(a) (providing that the filing of an application for review by the SEC shall stay the effectiveness of any sanction, other than a bar or expulsion, imposed in a decision constituting final disciplinary action of FINRA).
8. See Rule 9285(d).
9. FINRA also has made amendments to four existing rules to correspond to new Rule 9285: Rules 9235 (Hearing Officer Authority), 9311 (Appeal by Any Party; Cross-Appeal), 9312 (Review Proceeding Initiated by Adjudicatory Council), and 9321 (Transmission of Record).
10. See Rule 9285(e).
11. See Rule 9285(e)(4).
12. See Rule 9285(e)(2) and (3).
13. See Rule 9285(e)(1).
14. Section 3(a)(39) of the Exchange Act defines the circumstances when a person is subject to a “statutory disqualification.”
15. See 15 U.S.C. 78o-3(g)(2) (“A registered securities association may, and in cases in which the Commission, by order, directs as necessary or appropriate in the public interest or for the protection of investors shall, deny membership to any registered broker or dealer, and bar from becoming associated with a member any person, who is subject to a statutory disqualification.”); see also 17 CFR 240.19h-1.
16. See Rule 9522; see also [General Information on FINRA’s Eligibility Requirements](#).
17. See General Information on FINRA’s Eligibility Requirements, *supra* (explaining that “in virtually every application that the NAC approves, it will do so subject to the applicant member’s agreement to implement a special supervisory plan”).
18. See *Regulatory Notice 18-15* (April 2018).
19. See Rule 9522(a)(3) and (b)(1)(B).
20. Rule 9522 also has been amended to add provisions concerning determinations by the Department of Member Regulation (Member Regulation) that an SD Application that seeks the continued association of a disqualified person is substantially incomplete, and the consequences for failing to timely remedy a substantially incomplete application. See Rule 9522(f), (g), (h).



21. BrokerCheck helps investors make informed choices about the brokers and member firms with which they conduct business by providing extensive registration and disciplinary history to investors at no charge. FINRA requires member firms to inform their customers of the availability of BrokerCheck.
22. See Rule 3170(a)(2) (Taping Rule definition of “disciplined firm”).
23. The description of the Taping Rule has been added to finra.org. See <https://www.finra.org/taping-rule>.
24. See Rule 1017(a)(5); see also Rule 1011(m) (setting forth a non-exhaustive list of events that are material changes in business operations).
25. See Rule 1017(b)(2)(C) (“If the application requests approval of an increase in Associated Persons involved in sales, offices, or markets made, the application shall set forth the increases in such areas during the preceding 12 months.”).
26. The safe harbor is unavailable to a member firm that has a membership agreement that contains a specific restriction as to one or more of the three areas of expansion or to a member firm that has a “disciplinary history” as defined in IM-1011-1. The safe harbor also is not available to any member firm that is seeking to add one or more “associated persons involved in sales” and one or more of those associated persons has a “covered pending arbitration claim,” an unpaid arbitration award or unpaid settlement related to an arbitration. See Rule 1017(a)(6)(B); IM-1011-2 (Business Expansions and Covered Pending Arbitration Claims).
27. In 2015, FINRA’s Office of the Chief Economist (OCE) published a study that examined the predictability of disciplinary and other disclosure events associated with investor harm based on past similar events. The OCE study showed that past disclosure events, including regulatory actions, customer arbitrations and litigations of brokers, have significant power to predict future investor harm. See Hammad Qureshi & Jonathan Sokobin, *Do Investors Have Valuable Information About Brokers?* (FINRA OCE Working Paper, Aug. 2015). A subsequent academic research paper presented evidence that suggests a higher rate of new disciplinary and other disclosure events is highly correlated with past disciplinary and other disclosure events, as far back as nine years prior. See Mark Egan, Gregor Matvos, & Amit Seru, *The Market for Financial Adviser Misconduct*, J. Pol. Econ. 127, no. 1 (Feb. 2019): 233-295.
28. Rule 1017(a)(7) defines “owner,” for purposes of Rule 1017(a)(7), to have the same meaning as “direct owner” and “indirect owner” on the Uniform Application for Broker-Dealer Registration (Form BD), Schedules A and B, as amended from time to time.
29. Rule 1017(a)(7) defines “control person” to mean a person who would have “control” as defined on Form BD, as amended from time to time.
30. See Rule 1011(h) (defining “final criminal matter”); Rule 1011(p) (defining “specified risk event”). The definitions of “final criminal matter” and “specified risk events” are based on criminal events, arbitration awards, civil judgments, arbitration settlements, civil litigation settlements, civil judicial actions, and regulatory actions, as described in the definitions, that are disclosed, or are or were required to be disclosed,

on the “Uniform Registration Forms.” *See* Rule 1011(r) (defining “Uniform Registration Forms” to include the Form BD, the Uniform Application for Securities Industry Registration or Transfer (Form U4), the Uniform Termination Notice of Securities Industry Registration (Form U5), and the Uniform Disciplinary Action Reporting Form (Form U6)).

31. By its terms, Rule 1017(a)(7) does not apply when the member firm is required to file an SD Application or written request for relief pursuant to Rule 9522 (Initiation of Eligibility Proceeding; Member Regulation Consideration; and Requirements for an Interim Plan of Heightened Supervision) for approval of the same contemplated association.
32. *See* Securities Exchange Act Release No. 88600 (April 8, 2020), 85 FR 20745, 20758 (April 14, 2020) (Notice of Filing of File No. SR-FINRA-2020-011). FINRA developed the Rule 1017(a)(7) criteria and the definitions of “final criminal matter” and “specified risk event” with significant attention to the economic trade-off between including individuals who are less likely to subsequently pose risk of harm to customers, and not including individuals who are more likely to subsequently pose risk of harm to customers. *See id.* at 20754, 20758-59.
33. Other mandatory materiality consultations are required by Rule 1017(a)(6).
34. For technical assistance, please contact the FINRA Gateway Call Center at (301) 869-6699.
35. *See also* Rule 1017(b)(2) (requiring a member firm to submit a CMA that includes a Form CMA).
36. *See* Approval Order, 85 FR at 81546.

## Mapping of Disclosure Categories for FINRA Rule 1017(a)(7)

The table below is intended to help member firms determine whether a continuing membership application (Form CMA) or materiality consultation is required to be submitted to the Department of Member Supervision, Membership Application Group (MAP), to comply with FINRA Rule 1017(a)(7) by mapping the disclosure events relevant for the rule to the Uniform Registration Forms (i.e., Forms U4, U5, U6, and BD).

Pursuant to FINRA Rule 1017(a)(7), unless the member firm has submitted a written request to the Department of Member Supervision seeking a materiality consultation for the contemplated activity, a member firm is required to file a Form CMA whenever a natural person seeking to become an owner, control person, principal or registered person of a member firm has, in the prior five years, a record of one or more “final criminal matters” or two or more “specified risk events.” The terms “final criminal matter” and “specified risk event,” which are defined in FINRA Rule 1011, are based on events that are disclosed, or are or were required to be disclosed, on any of the Uniform Registration Forms.

In the table below:

- Where only specific Uniform Registration Form disclosure questions are listed for an event, the mapping is to an affirmative response to any one of those disclosure questions.
- Where only relevant Disclosure Reporting Pages (DRP) fields are listed for an event, the mapping is to:
  - a selection of any of the listed DRP structured fields (i.e., checkbox fields); *or*
  - entry of relevant text (e.g., the sanctions listed in the definition of “specified risk event” and their equivalents) in a listed DRP unstructured field (i.e., free-text field).
- Where specific Uniform Registration Form disclosure questions *and* relevant DRP fields are listed for an event, the mapping is to an affirmative response to any one of the listed disclosure questions *and either*:
  - a selection of any of the listed DRP structured fields (i.e., checkbox fields); *or*
  - entry of relevant text (e.g., the sanctions listed in the definition of “specified risk event” and their equivalents) in a listed DRP unstructured field (i.e., free-text field).

Questions regarding this mapping guidance table should be directed to [mappingguidance@finra.org](mailto:mappingguidance@finra.org).

This mapping guidance table may be updated periodically, as needed. FINRA will notify the membership of any such updates.

**Mapping of Disclosure Categories for Final Criminal Matters and Specified Risk Events (Forms U4, U5, U6 and BD)**

	Rule Subsection	Rule Text	Form U4 Question #	Form U5 Question #	Form U6* Question #	Form BD** Question #
Final Criminal Matters	1011(h)	The term “final criminal matter” means a criminal matter that resulted in a conviction of, or plea of guilty or nolo contendere (“no contest”) by, a person that is disclosed, or is or was required to be disclosed, on the applicable Uniform Registration Forms.	14A(1)(a), 14A(2)(a), 14B(1)(a), 14B(2)(a)	7C(1), 7C(3)	<ul style="list-style-type: none"><li>• Criminal DRP 4B (Disposition of Charge):<ul style="list-style-type: none"><li>o Convicted,</li><li>o Pled Guilty</li></ul></li></ul>	11A(1), 11B(1)
Specified Risk Events:	1011(p)	The term “specified risk event” means any one of the following events that are disclosed, or are or were required to be disclosed, on an applicable Uniform Registration Form:				
1) Customer Awards (above de minimis threshold) in which individual was named <sup>1</sup>	1011(p)(1)	a final investment-related, consumer-initiated customer arbitration award or civil judgment against the person for a dollar amount at or above \$15,000 in which the person was a named party;	14I(1)(b) <sup>2</sup>	7E(1)(b) <sup>2</sup>	<ul style="list-style-type: none"><li>• SRO Arbitration DRP 10A:<sup>2</sup><ul style="list-style-type: none"><li>o Award</li></ul></li></ul>	N/A <sup>3</sup>
2) Customer Settlements (above de minimis threshold) in which individual was named <sup>1</sup>	1011(p)(2)	a final investment-related, consumer-initiated customer arbitration settlement or civil litigation settlement for a dollar amount at or above \$15,000 in which the person was a named party;	14I(1)(d)	7E(1)(d)	<ul style="list-style-type: none"><li>• SRO Arbitration DRP 10A:<sup>4</sup><ul style="list-style-type: none"><li>o Settled</li></ul></li></ul>	N/A <sup>3</sup>
3) Final Civil Judicial Actions with (A) monetary sanctions (above de minimis threshold), or (B) bars and suspensions <sup>1</sup>	1011(p)(3)	a final investment-related civil action where: (A) the total monetary sanctions (including civil and administrative penalties or fines, disgorgement, monetary penalties other than fines, or restitution) were ordered for a dollar amount at or above \$15,000; or (B) the sanction against the person was a bar, expulsion, revocation or suspension;	14H(1)(a), 14H(1)(b) & <ul style="list-style-type: none"><li>• Civil Judicial DRP 12A: <sup>5</sup><ul style="list-style-type: none"><li>o Civil and Administrative Penalty(ies)/Fine(s),</li><li>o Disgorgement,</li><li>o Monetary Penalty other than Fines,</li><li>o Restitution</li></ul></li><li>• Civil Judicial DRP 12B<sup>6</sup></li></ul>	N/A <sup>7</sup> <ul style="list-style-type: none"><li>• Civil Judicial DRP 12A: <sup>5</sup><ul style="list-style-type: none"><li>o Civil and Administrative Penalty(ies)/Fine(s),</li><li>o Disgorgement,</li><li>o Monetary Penalty other than Fines,</li><li>o Restitution</li></ul></li><li>• Civil Judicial DRP 12B<sup>6</sup></li></ul>	11H(1)(a), 11H(1)(b) & <ul style="list-style-type: none"><li>• Civil Judicial DRP Part II, 13A:<ul style="list-style-type: none"><li>o Disgorgement/Restitution,</li><li>o Monetary/Fine</li><li>o Bar,</li><li>o Suspension,</li><li>o Revocation/Expulsion/Denial</li></ul></li><li>• Civil Judicial DRP 13B<sup>8</sup></li></ul>	
4) Final Regulatory Action with (A) monetary sanctions (above de minimis threshold), or (B) bars and suspensions <sup>1</sup>	1011(p)(4)	a final regulatory action where (A) the total monetary sanctions (including civil and administrative penalties or fines, disgorgement, monetary penalties other than fines, or restitution) were ordered for a dollar amount at or above \$15,000; or (B) the sanction against the person was a bar (permanently or temporarily), expulsion, rescission, revocation, or suspension from associating with a member.	14C, 14D, 14E & <ul style="list-style-type: none"><li>• Regulatory Action DRP 13A: <sup>9</sup><ul style="list-style-type: none"><li>o Civil and Administrative Penalty(ies)/Fine(s),</li><li>o Restitution,</li><li>o Disgorgement,</li><li>o Monetary Penalty other than Fines</li><li>o Bar (Permanent),</li><li>o Bar (Temporary/Time Limited),</li><li>o Rescission,</li><li>o Suspension,</li><li>o Revocation,</li><li>o Expulsion</li></ul></li><li>• Regulatory Action DRP 13C</li><li>• Regulatory Action DRP 13B<sup>10</sup></li></ul>	7D & <ul style="list-style-type: none"><li>• Regulatory Action DRP 12A: <sup>9</sup><ul style="list-style-type: none"><li>o Civil and Administrative Penalty(ies)/Fine(s),</li><li>o Restitution,</li><li>o Disgorgement,</li><li>o Monetary Penalty other than Fines</li><li>o Bar (Permanent),</li><li>o Bar (Temporary/Time Limited),</li><li>o Rescission,</li><li>o Suspension,</li><li>o Revocation,</li><li>o Expulsion</li></ul></li><li>• Regulatory Action DRP 12D</li><li>• Regulatory Action DRP 12B<sup>10</sup></li></ul>	<ul style="list-style-type: none"><li>• Regulatory Action DRP 13A: <sup>9</sup><ul style="list-style-type: none"><li>o Civil and Administrative Penalty(ies)/Fine(s),</li><li>o Restitution,</li><li>o Disgorgement,</li><li>o Monetary Penalty other than Fines</li><li>o Bar (Permanent),</li><li>o Bar (Temporary/Time Limited),</li><li>o Rescission,</li><li>o Suspension,</li><li>o Revocation,</li><li>o Expulsion</li></ul></li><li>• Regulatory Action DRP 13D</li><li>• Regulatory Action DRP 13B<sup>10</sup></li></ul>	11C, 11D, 11E & <ul style="list-style-type: none"><li>• Regulatory Action DRP Part II, 12A:<ul style="list-style-type: none"><li>o Disgorgement/Restitution,</li><li>o Monetary/Fine</li><li>o Bar,</li><li>o Suspension,</li><li>o Revocation/Expulsion/Denial</li></ul></li><li>• Regulatory Action DRP Part II, 12B<sup>10</sup></li></ul>

**Notes and Assumptions:**

\* The listed questions refer to the Form U6 for individuals (not firms).

\*\* Includes questions associated with control affiliates.

<sup>1</sup> De minimis threshold is \$15,000.

<sup>2</sup> Includes Customer Awards above de minimis threshold of \$15,000. On Forms U4 and U5, Customer Award amounts are reported on Customer Complaint/Arbitration/Civil Litigation DRP 11A. On Form U6, Customer Award amounts are reported on SRO Arbitration DRP 10C.

<sup>3</sup> Form BD does not include information on Customer Awards or Customer Settlements.

<sup>4</sup> Includes Customer Settlements above de minimis threshold of \$15,000. On Form U6, Customer Settlement amounts are reported on SRO Arbitration DRP 10C.

<sup>5</sup> Includes monetary sanctions associated with a Final Civil Judicial Action above de minimis threshold of \$15,000. On Forms U4 and U6, these sanctions amounts are reported on Civil Judicial DRP 12D.

<sup>6</sup> The Civil Judicial DRP lists “Other Sanctions.” The relevant sanctions are those listed in the Rule text, including Bar (permanent or temporary), Expulsion, Revocation or Suspension, and their equivalents.

<sup>7</sup> Form U5 does not include information on Civil Judicial Actions.

<sup>8</sup> The Civil Judicial DRP lists “Other Sanctions.” The relevant sanctions are those listed in the Rule text and their equivalents.

<sup>9</sup> Includes monetary sanctions associated with a Final Regulatory Action above de minimis threshold of \$15,000. On Form U4, these sanctions amounts are reported under Regulatory Action DRP 13E. On Form U5, these sanctions amounts are reported under Regulatory Action DRP 12F. On Form U6, these sanctions amounts are reported under Regulatory Action DRP 13F.

<sup>10</sup> The Regulatory Action DRP lists “Other Sanctions.” The relevant sanctions are those listed in the Rule text and their equivalents.